

DRAFT – FOR DISCUSSION PURPOSES ONLY

The following draft incorporates and substantially revises language that has been discussed by the work group that generally implements a “single-entity” approach to calculating the state-sourced income of the combined group. The draft attempts to take a “step-by-step” approach to this calculation.

1 Section 3. Determination of combined group income subject to tax.

2 A. Calculation of combined group state taxable net income.

3 i. Determine the total combined group income or loss, before net operating loss
4 deduction, as follows:

5 (a) Each member of the combined group determines its separate income or loss,
6 before net operating loss deduction, as follows:

7 (1) For a member incorporated in the United States, or included in a
8 consolidated federal corporate income tax return, the member’s income or loss
9 is the taxable income for the member under the Internal Revenue Code, on a
10 separate entity basis, after making appropriate adjustments under [state tax
11 code provisions for adjustments to taxable income].

12 (2) For any member not included in Section 3.A.ii.(a)(1):

13 (i) The member’s income or loss is determined from a profit and
14 loss statement prepared for that member on a separate entity basis in
15 the currency in which its books of account are regularly maintained,
16 provided this profit and loss statement is subject to an independent
17 audit, adjusted to conform it to the accounting principles generally
18 accepted in the United States for the preparation of such statements and
19 further modified to take into account any book-tax adjustments
20 necessary to reflect federal and [state] tax law. Income or loss so
21 computed includes all income wherever derived and is not limited to
22 items of U.S. source income or effectively connected income within the
23 meaning of the Internal Revenue Code. Items of income, expense, gain or

1 loss and related apportionment factors that are denominated in a foreign
2 currency must also be translated into U.S. dollars on a reasonable basis
3 consistently applied year-to-year and entity-by-entity. Unrealized foreign
4 currency gains and losses are not recognized. Income apportioned to this
5 state is to be expressed in U.S. dollars.

6 (II) In lieu of the procedures set forth in Section 3.A.i.(a)(2)(I) or in
7 any case where it is necessary to fairly and consistently reflect the
8 income or loss and apportionment factors of foreign operations included
9 in the unitary business, the [Director] may provide for other procedures
10 to reasonably approximate the income or loss and apportionment factors
11 of members with foreign operations.

12 (b) Unless otherwise provided by this Act, or by regulation, income or loss of the
13 members as determined under Section 3.A.i.(a) are combined, eliminating items of
14 income, expense, gain and loss from transactions between members of the combined
15 group, applying the consolidated filing rules under Internal Revenue Code and agency
16 regulations as if the combined group was a consolidated filing group.

17 (1) Dividends paid by one member of the combined group to another
18 member are excluded from that member's income to the extent those dividends
19 are paid out of the earnings and profits of the unitary business included in the
20 combined report in the current or an earlier year.

21 (2) A charitable expense incurred by a member of a combined group, to
22 the extent allowable as a deduction pursuant to Internal Revenue Code Section
23 170, is subtracted first from the apportionable income of the combined group
24 subject to the income limitations of that section applied to the entire
25 apportionable income of the group, and any excess may be carried over as
26 provided in Section 170, subject to limitations in that section.

27 ii. Determine combined group ordinary apportionable income or loss by eliminating
28 from the amount determined in Section 3.A.i:

1 (a) The amount of any net capital gain resulting from application of the Internal
2 Revenue Code, Subchapter P; and

3 (c) Any other income or loss, or item of income, expense, gain or loss, that is
4 nonapportionable.

5 iii. Determine state share of combined group ordinary apportionable income or loss by
6 multiplying the amount determined under Section 3.A.ii. times the combined group
7 apportionment factor as determined under Section 3.B.

8 iv. Determine the combined group state net capital gain or loss from the application of
9 the Internal Revenue Code, Subchapter P, and the amount of any state net capital loss
10 carryover, as follows:

11 [DRAFTER'S NOTE: If the state decouples from federal treatment of depreciation
12 and tax basis and requires taxpayers to compute separate state amounts for capital
13 gains, losses and/or loss carryovers, then insert language here referring to the section
14 that instructs taxpayers how to report state-adjusted capital gains and losses.]

15 (a) Each separate item of capital gain or loss for the combined group is
16 determined [following Internal Revenue Code, Subchapter P or state provisions
17 requiring the computation of state-adjusted capital gains and losses].

18 (b) Each separate item of apportionable capital gain or loss is then apportioned
19 using the combined group's apportionment factor determined under Section 3.B., and
20 each separate item of nonapportionable capital gain or loss is allocated under
21 [reference to state allocation and apportionment statute].

22 (c) The capital gains or losses allocated or apportioned to this state are then
23 netted consistent with the provisions of the Internal Revenue Code, Subchapter P.

24 (d) If the amount determined in Section 3.A.iv.(c) is a net capital gain, that gain is
25 included in combined group taxable net income or loss before net operating loss
26 deduction as computed under Section 3.A.vi.

27 (e) If the amount determined in Section 3.A.iv.(c) is a net capital loss, that loss
28 may not be deducted from other income but may be carried over by the combined
29 group and used to offset combined group capital gains, subject to [state law allowing a

1 net capital loss carryover], but only to the extent that the amount or use of such capital
2 loss carryover is not subject to limitations under any provision of the Internal Revenue
3 Code or applicable federal regulations, or would not be subject to such limitations
4 applied as if the combined group was the consolidated group.

5 (f) If the combined group capital loss carryover must be attributed to particular
6 members of the group for purposes of determining limitations applicable to the amount
7 or use of the capital loss under Section 3.A.iv(e) above, then this will be done by
8 multiplying the combined group net capital loss generated for any applicable year times
9 a fraction the numerator of which is the separate entity net capital loss of the member
10 for that year, if any, and the denominator of which is the total separate entity net
11 capital losses for all the members of the combined group that had net capital losses for
12 that year. A member's separate entity net capital loss carryover will be determined as
13 follows:

14 (I) For each year in which the combined group recognized a net capital
15 loss, multiply the combined group net apportionable gains and losses times the
16 member's separate entity apportionment factor determined under Section 3.B,
17 netting the resulting apportioned gains and losses as provided in this Section
18 3.A.iv; and then add or subtract

19 (II) Any nonapportionable gains or losses allocated to the state that were
20 generated by that member.

21 (III) In no case may members of the combined group be attributed total
22 capital losses under this Section 3.A.iv(f) in excess of the combined group net
23 capital loss properly reported to this state in the tax year.

24 (IV) In computing the net capital loss carryover for the member of the
25 combined group, the separate entity capital losses for all members computed
26 under this Section 3.A.iv.(f) will be deemed to be used to offset combined group
27 capital gains in other years, as allowed under [federal or separate state law], on
28 a pro-rata basis, starting with the earliest year.

1 v. Determine the amount of any combined group nonapportionable items of income,
2 expense, gain or loss not allocated under Section 3.A.iv(b) that are allocable to the state under
3 [reference to state allocation and apportionment statute].

4 vi. Determine the combined group state net income or loss before net operating loss
5 deduction by combining and netting the results from Section 3.A.iii, iv(d), and v.

6 vii. Determine the combined group state taxable net income after any net operating loss
7 deduction, by deducting from the amount of combined group state net income computed
8 under Section 3.A.vi an allowable amount of the combined group's net operating loss carryover,
9 determined under this Section 3.A.vii, as follows:

10 (a) The allowable amount of the combined group net operating loss carryover in
11 any tax year is:

12 (1) The total of the combined group state losses determined under
13 Section 3.A.vi for prior years to the extent such losses have not been used to
14 offset the combined group's state net income and to the extent those losses are
15 not otherwise limited by state law or this Section 3.A.vii; plus

16 (2) The net operating loss carryover of any members of the group created
17 before the member became a part of the group, but only to the extent that the
18 net operating loss carryover:

19 (I) represents net operating losses that were properly attributed
20 to the member under Section 3.A.vii(b) below if the member was part of
21 a separate combined group when the losses were created;

22 (II) represents net operating losses properly allocated or
23 apportioned to this state in the year created;

24 (III) has not been used to offset income of any taxpayer;

25 (IV) would not be subject to limitations as to the amount or use
26 applicable under any provision of the Internal Revenue Code or federal
27 regulations, or would not be subject to such limitations applied as if the
28 combined group was the consolidated group; and

29 (V) is not otherwise not limited by state law; minus

1 (3) The net operating loss carryover of a member of the combined group
2 attributed to that member under Section 3.A.vii.(c) below, that has not been
3 used to offset income and is not otherwise limited by state law as of the date
4 that member is no longer part of the combined group.

5 (b) If the combined group net operating loss carryover must be attributed to
6 particular members of the group for purposes of determining limitations applicable to
7 the amount or use of the net operating loss carryover under this Section 3.A.vii, then
8 this will be done by multiplying the combined group net loss generated for any
9 applicable year times a fraction the numerator of which is the separate entity net loss of
10 the member for that year, if any, and the denominator of which is the total separate
11 entity net losses for all the members of the combined group that had net losses for that
12 year. A member's separate entity net loss will be determined as follows:

13 (1) The amount of combined group ordinary apportionable income
14 determined under Section 3.A.ii multiplied times the member's separate entity
15 apportionment factor as determined under Section 3.B; plus

16 (2) The amount of any combined group net gain determined under
17 Section 3.A.iv. multiplied times the member's separate entity apportionment
18 factor as determined under Section 3.B; plus or minus

19 (3) The amount of any nonapportionable items of income, expense, gain
20 or loss allocated to the state under Section 3.A.v. that were generated by the
21 member; plus or minus

22 (4) Any adjustments to properly reflect the member's separate entity
23 loss.

24 (5) In no case shall members be attributed total losses under this Section
25 3.A.vii.(b) in excess of the combined group loss properly reported to this state in
26 the tax year.

27 (6) In computing the net operating loss carryover for the member of the
28 combined group, the separate entity net operating losses for all members
29 computed under this Section 3.A.iv.(f) will be deemed to be used to offset

1 combined group net income in other years, as allowed under [federal or
2 separate state law], on a pro-rata basis, starting with the earliest year.

3 viii. Application of state tax credits.

4 If the use of a tax credit provided in any other section of [this act] is limited to
5 the [state] tax attributed to a member of a combined group, then the tax that may be
6 offset by the credit is calculated as follows:

7 (1) The amount of combined group ordinary apportionable income
8 determined under Section 3.A.ii multiplied times the member's separate entity
9 apportionment factor as determined under Section 3.B; plus

10 (2) The amount of any combined group net gain determined under
11 Section 3.A.iv. multiplied times the member's separate entity apportionment
12 factor as determined under Section 3.B; plus or minus

13 (3) The amount of any nonapportionable items of income, expense, gain
14 or loss allocated to the state under Section 3.A.v. that were generated by the
15 member; plus or minus

16 (4) Any adjustments to properly reflect the member's separate entity
17 loss; multiplied by

18 (5) The applicable tax rate.

19 B. Allocation and apportionment.

20 i. Allocation and apportionment.

21 Unless otherwise provided in this Act, [reference to state allocation and apportionment
22 statute] determines how income or loss, or items making up income or loss, are allocated and
23 apportioned to this state.

24 ii. Combined group apportionment factor.

25 The combined group apportionment factor is a percentage determined under [reference
26 to state allocation and apportionment statute] where the numerator of the factor[s] includes
27 amounts sourced to the state for the combined group's unitary business, regardless of the
28 separate entity to which those factors may be attributed, and the denominator of the factor[s]
29 includes amounts associated with the combined group's unitary business wherever located.

1 iii. Separate entity apportionment factor.

2 The separate entity apportionment factor for a member of the combined group is a
3 percentage determined under [reference to state allocation and apportionment statute] where
4 the numerator of the factor[s] includes amounts sourced to the state for the member, and the
5 denominator of the factor[s] includes amounts associated with the combined group's unitary
6 business wherever located.

7 iv. If the combined group or a member of the group holds a partnership interest from
8 which it derives apportionable income, the share of partnership apportionment factor[s] to be
9 included in the apportionment factor[s] of the group or member is determined by multiplying
10 the partnership's factor[s] by a ratio the numerator of which is the amount of the distributive
11 share of the partnership's apportionable income included in the income of the combined group
12 or member, and the denominator of which is the amount of the partnership's total
13 apportionable income.

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